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Tariffs in American History

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TARIFFS ARE among the oldest of taxes for the simple reason that they are easy to collect. Just send in the tax collectors and don't let the goods being transported move until the duty has been paid. Being one of the earliest forms of taxation, it is not surprising that tariffs produced one of the earliest forms of tax evasion: smuggling.

In America's colonial period, the east coast of the United States, with its many rivers and inlets that the small ships of those days could utilize, lent itself to smuggling, and the American colonists evaded British tariffs on a grand scale.

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Indeed, Rhode Island, with its long coastline relative to the area and its many small harbors, was the epicenter of colonial smuggling, and it opposed any attempts to suppress it. Rhode Island was the first colony to foreswear allegiance to Great Britain, on May 4, 1776, two months before the Declaration of Independence. It was also the only state not to send delegates to the Constitutional Convention in Philadelphia in 1787, fearing that a stronger federal government, empowered to tax, would suppress smuggling. And it was the last state to ratify the Constitution, on May 29, 1790, more than a year after the federal government had come into existence. It did so then only under the threat of having its exports taxed as if from a foreign nation.

When the Constitution took effect in 1789, the first order of business was to straighten out the nation's disastrous financial situation. That is why the new State Department started out with only five employees while the Treasury Department had 40.

When Alexander Hamilton became the nation's first Secretary of the Treasury, he immediately began to prepare a schedule of tariffs, along with excise taxes on such commodities as alcohol and tobacco. The Constitution forbids taxing the exports of any state, and so American tariffs have always been laid only on imports.

Collectors were named for each port, and these were considered plum jobs because the collector got to keep the money, earning interest on it, until it was forwarded to the federal government a few times a year.

Hamilton's tariffs, along with the refunding of the national debt and the establishment of a central bank, transformed the American financial situation. By the end of the 1790s, the U.S. had the best credit rating in Europe, its bonds selling over par. By 1800, federal revenues, a mere $3.7 million in 1792, had nearly tripled to $10.8 million. About 90 percent of that revenue came from tariffs—a ratio that wouldn't change much, except during the Civil War, for more than a century.

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Hamilton's tariffs had been solely for the purpose of raising revenue. But, of course, there is another use to which tariffs can be put: the protection of domestic industries from foreign competition.

In 1789, except for shipbuilding, there had been little American industry to protect. At his first inauguration, George Washington had been symbolically careful to wear a suit made of cloth woven in the U.S. rather than from cloth imported from Britain, as almost all high-quality cloth was at that time.

Britain was where the industrial spinning and weaving technology was, and Britain was determined to keep it there. Textile machinery, as well as plans for it, could not be exported—and those with expertise in the industry were not allowed to emigrate. This problem (when seen from an American viewpoint) was solved through industrial espionage. Samuel Slater, who had apprenticed in the cloth industry and had a marked talent for mechanics, carefully memorized the needed plans for spinning and weaving machinery and sailed to America, having listed himself as a farmhand on the ship's manifest.

Within a year, using capital from Rhode Island's Brown family (for whom Brown University is named), Slater had a spinning mill in operation. The American Industrial Revolution had begun—and with it a push for protective tariffs.

New England, with its many clear-running streams and rivers to provide waterpower, soon had a flourishing spinning industry, whereas the weaving of cloth was still initially done at home. But in 1814, Francis Cabot Lowell built a factory that would merge spinning and weaving into the first fully integrated cloth mill in the world.

WHEN THE CONSTITUTION TOOK EFFECT IN 1789, THE FIRST ORDER OF BUSINESS WAS TO STRAIGHTEN OUT THE NATION'S DISASTROUS FINANCIAL SITUATION. THAT IS WHY THE NEW STATE DEPARTMENT STARTED OUT WITH ONLY FIVE EMPLOYEES WHILE THE TREASURY DEPARTMENT HAD 40. WHEN ALEXANDER HAMILTON BECAME THE NATION'S FIRST SECRETARY OF THE TREASURY, HE IMMEDIATELY BEGAN TO PREPARE A SCHEDULE OF TARIFFS, ALONG WITH EXCISE TAXES ON SUCH COMMODITIES AS ALCOHOL AND TOBACCO. THE CONSTITUTION FORBIDS TAXING THE EXPORTS OF ANY STATE, AND SO AMERICAN TARIFFS HAVE ALWAYS BEEN LAID ONLY ON IMPORTS.

The Embargo Act of 1807 and the Non-Intercourse Act of 1809 had disrupted the importation of British cloth, and the War of 1812 had ended it. With a near monopoly in the American market, New England's nascent textile industry flourished. But the end of the war with Britain in 1814 brought renewed British competition and even the dumping of cheap British cloth in the American market. To protect their profits, New England cloth manufacturers, led by Lowell, went to Washington and lobbied for a protective tariff.

Protective tariffs have a surface plausibility, especially where new industries are just getting on their feet and are not yet as efficient as older foreign ones. But tariffs, as noted, are taxes, which are largely paid by domestic consumers, not foreign manufacturers. They also often allow domestic manufacturers to raise their own prices. Regardless, Lowell and his fellow manufacturers got Congress to impose a 25-cent-per-yard tariff on British cotton cloth.

By the 1820s, American manufacturing, hardly existent in 1789 when the Constitution had come into effect, was growing at enormous speed. In 1824 there were two million people employed in manufacturing, ten times the number of only five years earlier. But almost all that manufacturing was taking place in Northern states. The South, wedded to the fantastic profits generated by cotton production after the invention of the cotton gin, remained almost wholly agricultural.

So Northern voters increasingly wanted a high tariff to protect their industries and their jobs, and Southern voters wanted a low tariff to reduce the prices they had to pay for manufactured goods. This sectional dispute led to the first existential threat to the Union.

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The national debt had tripled during the War of 1812, after which surpluses from tariffs were used to pay it back down. Indeed, with its fast-rising industrial sector, the Northern states wanted even higher tariffs on industrial goods.

In 1828, as a new tariff bill was moving through Congress, Southern politicians thought they had a way to defeat it. While New England's vast textile industry wanted high tariffs on industrial goods such as cloth, it needed to import such raw materials as wool, flax for making linen, and hemp for making rope for its shipbuilding industry. Southern congressmen inserted high tariffs of 45 percent on these commodities into

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the bill hoping to split off enough New England congressmen to defeat it. Their attempt failed, the tariff bill passed, and President John Quincy Adams signed it into law even though he knew it would hurt him politically. The South, ever an exporter of snappy political phrases, dubbed it the "Tariff of Abominations," as it has been known ever since.

Adams was, indeed, defeated in his re-election bid by Andrew Jackson. But Jackson, while a Southerner himself, was determined to pay off the national debt and was willing to tolerate a high tariff in order to do so. Not so his vice president, John C. Calhoun of South Carolina, who was adamantly opposed to the tariff of 1828. After its passage, Calhoun anonymously wrote a pamphlet asserting the right of states to nullify federal laws that they regarded as unconstitutional.

In November of 1832, after the tariff bill of that year did not lower tariffs enough to suit Southern demands—tariffs on specific industrial products were lowered from 45 to 35 percent, but others remained the same—the South Carolina legislature passed an Ordinance of Nullification, declaring the tariffs of 1828 and 1832 to be null and void within the borders of the state.

President Jackson would have none of that. Not given to mincing words, he wrote: "I consider . . . the power to annul a law of the United States, assumed by one State, incompatible with the existence of the Union, contradicted expressly by the letter of the Constitution, unauthorized by its spirit, inconsistent with every principle on which it was founded, and destructive of the great object for which it was formed."

Jackson threatened military action if necessary to enforce federal law and was authorized by Congress to use it. Only the Compromise Tariff of 1833, in which duties were to be reduced over ten years to the levels of 1816, brought the crisis to an end, with South Carolina repealing its Ordinance of Nullification.

With American industry becoming ever more efficient—thanks in no small part to the country's secret weapon, Yankee ingenuity—tariff protection became less necessary, and tariffs generally trended downwards until the coming of the Civil War.

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With the outbreak of war in 1861, government expenses exploded. Prior to the firing on Fort Sumter, the federal government had been spending about $172,000 a day. By the Battle of Bull Run three months later, the War Department alone was spending $1 million a day. While much of the cost of the war could be thrown onto the future by selling bonds, taxes—including tariffs—rose sharply as well. There were also new taxes, such as the country's first income tax and a stamp tax on legal documents.

The combination of wartime demand and high tariffs produced an enormous boom in American industry as new domestic production replaced foreign imports. After the war, this new industry demanded protection against foreign competition, while the South, always opposed to high tariffs, was politically prostrate.

Also there was the need to pay off the colossal debt incurred during the war. With wartime tariffs still largely in place, the federal government ran 28 straight surpluses between 1866 and 1894, despite a serious depression from 1873 to 1879. The debt in dollar terms was cut by more than half between 1866 and 1900, and as a percentage of the fast-rising GDP it fell by far more.

But tariffs are a consumption tax and therefore fall hardest on the poor, who must spend all their income to buy necessities. So there was increasing political pressure for an income tax on the rich that would finance a lowering of tariffs. But in 1895, the Supreme Court ruled such a tax unconstitutional. Meanwhile tariffs trended down only slightly.

In 1899, a legal dispute between Henry Clay Frick and Andrew Carnegie caused the enormous profits of the privately held Carnegie Steel Company to become public. By then, Carnegie Steel was manufacturing so efficiently that the company was successfully exporting to both Great Britain and Germany, where the steel industry had been born. With the facts in the open, the excuse that American industry needed protection from more efficient European companies began to collapse. As a result, tariffs began to decline significantly. Average tariffs, above 50 percent in 1900, were under 20 percent by 1920.

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Although American industry flourished in the 1920s, the agricultural sector of the economy did not. American farming had been hugely profitable during World War I, thanks to a steep decline in European production as farmhands went to war, as well as to the Ottoman Empire's blockade of Russia's wheat exports, which had been the largest in the world in 1913. Peace brought that agricultural prosperity to a rapid halt, and drought in the American Midwest made matters worse. Rural banks began to fail at an average rate of 500 per year during the '20s. Worse still, the rapid spread of the automobile and the tractor caused more and more land that had been devoted to fodder crops—about one-third of the total land under cultivation in 1900—to be used to produce food for humans instead, driving down prices sharply.

In 1928, presidential candidate Herbert Hoover promised farmers a protective tariff on farm products. But by the time Hoover became president and the bill was considered in Congress, the Wall Street crash had happened and the economy was moving into recession. What resulted was a feeding-frenzy of special interests. Industries and whole economic sectors alike sought protection in the slowing economy and Congress obliged. Even tombstone makers got a protective tariff.

The result, called the Smoot-Hawley Tariff after its principal sponsors in the Senate and House, was to raise the tariff on 20,000 imported commodities. It was the highest tariff in American history.

Economists were appalled and more than a thousand signed a petition asking Hoover to veto the bill. Thomas Lamont, a senior partner at J.P. Morgan and Company, wrote: "I almost went down on my knees to beg Herbert Hoover to veto the asinine Hawley-Smoot Tariff. That Act intensified nationalism all over the world."

ONE OF THE PROVISIONS AGREED TO BY THE U.S. IN THE EARLY GATT AGREEMENTS FOLLOWING WORLD WAR II WAS DIFFERENTIAL TARIFFS: THE U.S. LOWERED ITS TARIFFS MORE THAN ITS TRADING PARTNERS DID. AGAIN, THE PURPOSE OF THIS WAS TO SPEED THE ECONOMIC REBUILDING OF ALLIES AND FORMER ENEMIES WHO HAD SUFFERED DEVASTATION DURING THE WAR. BUT WORLD WAR II HAS NOW BEEN OVER FOR 80 YEARS. THE ECONOMIC RECOVERY OF WESTERN EUROPE AND THE FAR EAST HAS LONG SINCE BEEN ACCOMPLISHED. YET THE DIFFERENTIAL TARIFFS IN MANY CASES ARE STILL IN EXISTENCE.

Lamont was right. Foreign countries quickly built their own tariff walls to unprecedented heights and world trade collapsed. In 1929, it had amounted to about $36 billion. By 1932, global trade was only $12 billion, one-third as much. American exports had been $5.241 billion in 1929. Three years later they were down to $1.161 billion, a 78 percent drop. In constant dollar terms, American exports were lower than they had been in 1896 when the economy had been one-fifth the size.

Congress's Smoot-Hawley Tariff, the Federal Reserve's keeping interest rates high in order to protect the gold standard, and the Hoover administration's attempt to balance the budget in 1932 with sharply higher taxes, were the three huge public-policy mistakes that converted an ordinary stock market crash and recession into the Great Depression.

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In World War II, the industrial bases of Germany and Japan were flattened and those of the other great powers, except for the U.S., were severely impacted. In a rare example in the history of foreign policy of enlightened self-interest, rebuilding their economies was a major priority for the U.S. The intention was to restore prosperity in these devastated countries and thus to make them less susceptible to the Soviet aggression that had already taken much of Eastern Europe.

Reviving world trade was an important component of that. In 1947, 23 countries met in Geneva, Switzerland, and they established the General Agreement on Tariffs and Trade (GATT). Recognizing how counterproductive the beggar-thy-neighbor trade policies of the 1930s had been, the preamble called for a "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis." The "other trade barriers" included quotas, import and export licenses, domestic tax reductions on exports, and direct subsidies.

In the first round of GATT negotiations, 45,000 tariffs were reduced, affecting about $10 billion in annual world trade. Further rounds, eight in all—the latest is still ongoing—followed as more and more countries joined GATT. Each round saw further reductions in tariffs and trade barriers.

In 1995, GATT evolved into the World Trade Organization (WTO). In 1999, Communist China, which had seen explosive economic growth since the death of Mao Zedong in 1976, was admitted to the WTO. It was hoped that by being allowed to join the club, China would follow the rules. It has not. It has been guilty of massive theft of intellectual property as well as other nefarious trade policies as it made exports the centerpiece of its economy.

GATT was arguably the most successful diplomatic effort in world history. As noted, in 1932, global trade had amounted to $12 billion. By 2023 it had grown to $23 trillion. In other words, global trade, in constant dollars, has multiplied more than 80 times in 80 years.

To see an example of how much this has changed the world, look at the labels on your clothes. In 1947, they would mostly have been made in Manhattan's Garment District and in other such centers of the American clothing industry. Today they are made in such places as Bangladesh, Nicaragua, and Cambodia. These countries have a large comparative advantage in clothing manufacturing—which is labor intensive but not capital intensive—thanks to their very low semi-skilled labor costs. And while the wages of these countries are very low compared with American wages even today, they are a lot more than what these people were earning two generations ago. In 1950, according to the World Bank, 62.12 percent of the world's population was living in extreme poverty. In 2017, the percentage had fallen to 9.18 percent.

Never in human history has poverty fallen so far so fast. No small part of that triumph has been the lowering of trade barriers, first and foremost tariffs.

To be sure, not all of this enormous increase in world trade is due to GATT. One of the most important, if perhaps least exciting, inventions of the 20th century was the shipping container. It not only greatly reduced turnaround times because ships could be loaded and unloaded much more quickly, but it also eliminated, almost entirely, the enormous dockside pilferage that had been a chronic problem in all the world's major ports.

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One of the provisions agreed to by the U.S. in the early GATT negotiations following World War II was differential tariffs: the U.S. lowered its tariffs more than its trading partners did. Again, the purpose of this was to speed the economic rebuilding of allies and former enemies who had suffered devastation during the war. But World War II has now been over for 80 years. The economic recovery of Western Europe and the Far East has long since been accomplished. Yet the differential tariffs in many cases are still in existence.

The U.S., for instance, has a 2.5 percent tariff on cars imported from Germany, while Germany has a ten percent tariff on American cars. In addition, Germany's value-added tax is remitted on exports but charged on imports. As a result, while the logos of Mercedes-Benz, BMW, and Volkswagen are seen all over American roads, those of Ford and General Motors are a rare sight in Germany. And China, as already noted, is far worse, a world outlier, in terms of its nefarious trade policies.

President Trump wants to level this playing field. To do so, he has started what some are calling a trade war and others are calling the greatest example of "the art of the deal" in history. We will have to wait and see how it plays out. ■

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